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TREASURY FOR CLAY LOWERY, NANCY LEE, AJEWEL, WBLOCK, LTRAN
NSC FOR JOSE CARDENAS, ROD HUNTER
PASS FED BOARD OF GOVERNORS FOR RANDALL KROSZNER, PATRICE
ROBITAILLE
PASS EXIM BANK FOR MICHELE WILKINS
PASS OPIC FOR JOHN SIMON, GEORGE SCHULTZ, RUTH ANN NICASTRI
USDOC FOR 4322/ITA/MAC/OLAC/PEACHER

E.O. 12958: N/A

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SUBJECT: ARGENTINA ECONOMIC AND FINANCIAL REVIEW, MAY 21 -
31, 2007

¶1. (U) Provided below is Embassy Buenos Aires' Economic and
Financial Review covering the period May 21 - 31, 2007. The
unclassified email version of this report includes tables and

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charts tracking Argentine economic developments. Contact
Econoff Chris Landberg at landbergca@state.gov to be included
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Highlights

-- Energy Shortages Bite
-- Central Bank reserves top \$40 billion
-- Counter Terrorism Finance bill clears Senate Committees
-- ICSID rules against Argentina for \$106.2 million
-- Unemployment continues to fall

Economic Outlook

Energy Shortages Bite

¶2. (SBU) This week Argentine natural gas distributors cut the
supply to some industries and wholesale users as household
heating demand rose sharply due to extremely cold weather.

On May 28, exports to Chile were temporarily cut off. With a large share of Argentina's non-hydro electricity generating capacity fired by natural gas, electricity supplies to large customers have also been rationed and some urban centers, including Buenos Aires, have experienced short rolling blackouts over the past week. Local media highlighted protests by Buenos Aires taxi drivers unable to find adequate compressed natural gas to fuel their vehicles.

13. (SBU) Cristian Folgar, Undersecretary of Energy for Fuels, said May 29 that domestic energy demand would be met: "We're calm," Folgar said. "Our two systems of gas and electricity are functioning at full capacity and this will be sufficient to meet the demand we have...we are prioritizing residences, compressed natural gas (for vehicles) and some industrial uses."

14. (SBU) Argentina's austral winter is just starting, and so more energy cuts in coming weeks and months are possible. While some analysts see current energy shortages threatening more than four years of economic growth of over 8.5% per year, embassy industry contacts, argue that current cuts will not dampen economic activity significantly; many industrial users are implementing contingency plans to switch from gas to more expensive and less environmentally friendly fuel oil and diesel to operate their plants.

15. (SBU) Argentina has experienced an energy crunch since the economy rebounded from deep crisis in 2001-02, with tariff caps and price controls simultaneously boosting demand and dampening investment. In 2004, the GoA began limiting natural gas exports to Chile (in violation of its contract), began importing natural gas from Bolivia, and initiated low key energy rationing.

Banking and Finance

Central Bank reserves top \$40 billion

16. (SBU) Argentina's Central Bank (BCRA) reserves exceeded \$40 billion on May 21, the highest level in the country's history. The previous high, pre-crisis, was \$37.4 billion in January 2001. These record levels are the result of the BCRA's official but not quite public policy of maintaining an undervalued currency. It does this by buying up foreign exchange to avoid peso appreciation, and then engaging in sterilization operations to avoid a monetary impact. The BCRA has been buying over \$100 million per day for the last three weeks, injecting over 300 million pesos per day into the economy that it must then absorb by issuing short term debt (mainly Lebacs and Nobacs, or Letters of the central bank and Notes of the central bank). The BCRA's total peso debt is currently about \$18 billion.

17. (SBU) The BCRA argues that reserve accumulation is an insurance against exogenously imposed crisis, and BCRA President Redrado does not openly recognize that the BCRA's goal is to prevent peso appreciation. However, local media and analysts treat it as an open secret that the BCRA is pursuing this policy at President Kirchner's behest. Redrado has stated that the BCRA will maintain this policy as long as the BCRA's balance does not show a deficit (known as a "quasi fiscal deficit"). However, the job of maintaining an undervalued peso is getting tougher with the huge inflow of foreign currency from exports and increasing foreign investment in financial assets and property, and the BCRA is struggling to absorb the inflow to maintain the quasi-fixed nominal exchange rate of about 3.08 pesos/USD. The BCRA has bought \$8 billion since the beginning of 2007 and \$1.3 billion in the first three weeks of May. Private analysts estimate that the BCRA will purchase \$16.5 billion in 2007, or \$2.5 billion more than in 2006. Meanwhile, the BCRA has sterilized 15.2 billion pesos so far this year, almost 50% more than during the same period last year.

Counter Terrorism Finance bill clears Senate Committees

¶8. (SBU) Argentine Senator Vilma Ibarra, Chair of the Justice and Penal Issues Committee in the Senate, chaired a joint meeting of her Committee, the International Security and Narcotrafficking Committee, and the National Economy and Investment Committee on May 22 to debate the draft counter terrorism and counter terrorism finance (CTF) bill, which President Kirchner sent to the Senate on December 20, 2006. The three Committees approved the bill and will pass it for full Senate hearing on/about June 6, where most analysts expect it will pass with ease.

¶9. (SBU) Local media report that even if the Senate approves the bill within the next two weeks, this will not give the Chamber of Deputies sufficient time to approve it before the late-June plenary of the Financial Action Task Force (FATF). FATF, of which Argentina is a member, has given the GoA until the next plenary to get full Congressional approval of the draft law, or else face possible sanctions. (Note: almost all FATF member countries have legislation criminalizing the financing of terrorism. Other than Argentina, the exceptions are Turkey and Mexico, which are in the process of finalizing their laws, and Brazil, which has an older law that the GoB argues can be used to penalize the terrorism financing. End

Note)

¶10. (SBU) Senator Ibarra and other Senators present from President Kirchner's coalition expressed strong support for the bill and emphasized the importance of complying with FATF recommendations and avoiding sanctions, which they noted could have a severely negative impact on Argentine companies, financial institutions, and economy in general.

¶11. (SBU) The GoA's National CTF Coordinator and a representative from the Attorney General's office participated as observers in the meeting, as did a representative of the human rights NGO "CELS" (Centro de Estudios Legales y Sociales). The CELS representative criticized the bill, arguing that it did not respect international humanitarian laws, and also alleging that it could be used to target other activities, such as social protest, as "acts of terror." However, the GoA representatives clarified that the bill carefully defined "acts of terror" to avoid ambiguity. They noted the draft corresponded closely to UN Resolutions on money laundering and counter terrorism finance, all of which Argentina has signed and ratified.

ICSID rules against Argentina for \$106.2 million

¶12. (SBU) On May 22, the International Center for the Settlement of Investment Disputes (ICSID), an independent tribunal associated with the World Bank, ruled against Argentina in a case filed by Enron Corporation and Ponderosa Assets, L.P., former shareholders of Transportadora de Gas del Sur (TGS - a natural gas pipeline company). The ruling was for \$106.2 million in damages vs. Enron's claimed losses totaling between \$453 and \$582 million since 2001 due to the government's freeze in gas tariffs. In addition to the compensation award, the ICSID arbitral panel ruled that the GoA must pay interest of Libor plus 2%, retroactive to January 2002, for an estimated total of approximately \$165 million. (Note: Enron sold its 15.2% of its shares of TGS to DW Shaw investment fund.) There are 31 other ICSID claims pending against Argentina, totaling \$18 billion in damages. The bulk of these claims stem from the GoA's unwillingness to allow utility companies to raise tariffs to compensate for the post-crisis devaluation of the peso.

Labor Economy

Unemployment continues to fall

¶13. (SBU) The official GoA unemployment rate, which treats unemployed beneficiaries of GoA "labor plans" as employed, fell from 11.4% in Q1 of 2006 to 9.8% in Q1 2007. The actual rate, which counts labor plan beneficiaries as unemployed, fell even more in percentage terms, from 14.1% to 11.1%. President Kirchner said on May 30 that the 9.8% rate of Q 1 2007 fell to 8.3% in April, although the official release will only take place on June 6. These figures indicate that unemployment, whatever the measurement, is still decreasing following its peak in 2002 of 21.5% (or 26% including labor plan beneficiaries). Also, the number of people who receive unemployment subsidies ("labor plans") is lower than a year ago, both in absolute value and as a percentage of the labor force.

¶14. (SBU) A local consulting company -- Macrovision -- doubts this reduction in unemployment will significantly contribute to potential GDP growth, since a good part of the previous unemployed are informal workers ill-prepared to take up jobs in an expanding formal sector without investment in training and education. Macrovision calls it unlikely that the rate of unemployment will quickly converge to Argentina's historical natural rate of 6%. Even if it does, the marginal productivity of labor will not be high. SEL Consultants, which focuses on social issues in Argentina, estimates that the current natural rate of unemployment in Argentina is closer to 9%, much higher than the average 5% unemployment rate for the 1974 - 1992 period. SEL points out that unemployment affects the informal sector primarily, where government labor policy interventions are not effective. SEL's classification of the unemployed, based on the economic sectors from which they were expelled, shows that most of them are increasingly coming from the informal sector.

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